INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	7
Conclusion	9
Appendix	10

CITATIONS

Cases:	
Commissioner v. *Tower*, 327 U. S. 280	8
Lusthaus v. *Commissioner*, 327 U. S. 293	8
Statutes:	
Internal Revenue Code:	
Sec. 22 (26 U. S. C. 1940 ed., Sec. 22)	10
Sec. 181 (26 U. S. C. 1940 ed., Sec. 181)	10
Sec. 182 (26 U. S. C. 1940 ed., Sec. 182)	10
Sec. 3797 (26 U. S. C. 1940 ed., Sec. 3797)	11
Miscellaneous:	
Treasury Regulations 103:	
Sec. 19.22 (a)–1	11
Sec. 19.181–1	11
Sec. 19.182–1	12
Sec. 19.3797–4	13

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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 566

EDWARD P. FLETCHER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 73–76) is reported at 164 F. (2d) 182. The findings of fact and opinion of the Tax Court of the United States (R. 14–21) are reported at 7 T. C. 1186.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 77) was entered November 5, 1947. The petition for a writ of certiorari was filed February 2, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the finding and decision of the Tax Court that, under the facts, the petitioner was taxable for the year 1941 under Section 22 (a) of the Internal Revenue Code upon the entire income of the Fletcher Oil Company instead of upon two-thirds of such income, as contended by the petitioner, by reason of a purported partnership existing between the petitioner and his sister.

STATUTE AND REGULATIONS INVOLVED

The material provisions of the Internal Revenue Code and Treasury Regulations involved are printed in the Appendix, *infra,* pp. 10–13.

STATEMENT

This proceeding involves a deficiency in federal income tax asserted against the petitioner, Edward P. Fletcher, herein sometimes referred to as the taxpayer, for the taxable year 1941, in the sum of $8,091.09. (R. 5–8, 14.) The facts found by the Tax Court, which were not questioned in the court below and are not questioned here, are, briefly, that the taxpayer began to do business in 1925 as a sole proprietor under the name of Fletcher Oil Company. The business originally was the wholesale distribution of gasoline, motor oil, tires, batteries and related products. He built up the business from one station until it included six retail stations and had a number of dealers as customers. At the close of 1940 the assets of the business were

carried on the books at $338,466.44, less a reserve of $61,667.40 for depreciation and a reserve of $20,989.59 for bad debts. The total capital was carried at $201,323.35. The remaining item was liability of $54,486.10. (R. 15.)

The taxpayer was about forty-one years of age in 1941. He lived in Utica, New York, with his wife and adopted daughter, then twelve years of age. He had two brothers and two sisters. One brother was unable to work regularly due to an injury. He receives a pension. The other brother, Vincent Fletcher, is regularly employed by the Fletcher Oil Company. One sister is married and lives in Dannemora, New York. The other sister, Helen Fletcher, is unmarried and lives in Utica with the taxpayer's mother. None of the others just mentioned lived with Helen Fletcher and their mother at any time material to this proceeding. The mother was about seventy-one years of age in 1941. (R. 14–15.)

At all times material to this proceeding Helen Fletcher had full-time employment as a secretary for a newspaper at an annual salary of about $1,500. She took care of her mother, but her income was not sufficient to support their mother in the way the taxpayer desired. He had contributed to his mother's support. (R. 15.)[1]

[1] The record does not show the extent to which the taxpayer aided in the support of his mother, but the testimony indicates he was quite generous financially with the members of his family. (R. 43, 52.)

In the latter part of 1940 the taxpayer had a talk with his mother and Helen in which he stated that he intended to give Helen $50,000 and one-third of the income of his business. The Tax Court found that the taxpayer "never actually gave Helen $50,000, but he entered into a written agreement with her at some undisclosed date in July 1941." (R. 15.) This agreement (R. 59–63), after reciting that the taxpayer owned the assets of the Fletcher Oil Company; that they were needed in the business; and that the taxpayer, desiring to give $50,000 to his sister, Helen, had transferred to her $50,000 of the capital account of the oil company and had set up on the books of the company a capital account in that amount in her name, purported to "confirm" the transfer of $50,000 of the capital account of his business to his sister, such transferred account "to be carried in the name of Helen Fletcher and such capital account * * *, shall remain unchanged, neither increased or diminished by the subsequent profits or losses of the Fletcher Oil Company." (R. 59–60.)

The agreement then provided that the parties, by reason of their joint ownership of the assets, should continue to conduct the business of Fletcher Oil Company, with the same assets, as a partnership, for an indefinite period, and that the taxpayer should "continue as the General Manager of the partnership." (R. 60.) The agreement then provided for determination of the net

profits and losses at the end of each fiscal year and the debit or credit of such profit or loss upon the books of the Oil Company to an "Undivided Profits Account" and thereafter to their personal accounts in the proportion of 66⅔ per cent to the taxpayer and 33⅓ per cent to his sister. The amount of credit as shown in each personal account was made subject to withdrawal in cash "at such time as the cash position of the company warrants the same and the opinion of Edward P. Fletcher as to the availability of cash for withdrawal purposes will be final." (R. 60–61.)

It also was agreed that in the event the taxpayer's sister should have an opportunity to sell or dispose of her $50,000 interest in the capital account of the Fletcher Oil Company, or any part thereof, she should first give notice to the taxpayer in writing of her intention, whereupon the taxpayer was to have six months within which he could purchase the interest of his sister for $50,000, together with the amount as shown to her credit in her personal account and any amount to which she might be entitled which had not been transferred from the Undivided Profits Account of the Company to her personal account. (R. 61.)

The agreement further provided that the partnership should not be dissolved upon the death of either partner, but that the personal representative of the deceased partner should immediately succeed to his or her interest in the partnership and have the same rights and powers of

the deceased partner. Provision was made for purchase of the deceased partner's interest by the surviving partner upon the giving of notice within one year after the death of the deceased partner. (R. 62–63.)

The above agreement has never been changed or terminated. (R. 18.)

The taxpayer discussed with his attorney and his auditor the question of the necessary book entries to carry out the agreement and left the matter to them. He filed a federal gift tax return for 1941 reporting a gift of $50,000 to Helen Fletcher on January 1, 1941, with the tax due thereon in the amount of $99. (R. 18.)

The taxpayer did not need or desire new capital for his business. He would not have sold a one-third interest in the net profits of his business to an outsider for a contribution of $50,000 to its capital. One of his purposes in entering into the agreement with his sister was to reduce his income taxes. Another was to provide his sister with additional income and estate in order to help support their mother. His sister did no work for the Fletcher Oil Company at any time material hereto. The taxpayer's brother, Vincent, was given increased responsibility by the taxpayer and had practically full charge of the retail branch of the business either shortly before or shortly after the agreement of July, 1941. (R. 19.)

On his income tax return for 1941, the taxpayer reported $29,952.68 representing income from the

Fletcher Oil Company, which he stated thereon was a partnership. The Commissioner, in determining the deficiency here involved, added to the taxpayer's income the sum of $15,600.80, with the explanation that the profits from the Fletcher Oil Company constituted income of the taxpayer. (R. 18–19.)

The record does not disclose what amounts, if any, were withdrawn by Helen from the Fletcher Oil Company during 1941, except that $6,500 of United States Government bonds were purchased in Helen's name in December, 1941, with funds of the oil company.[2] The record does not show anything with respect to Helen's 1941 return. (R. 19.)

ARGUMENT

This is another case involving the taxation, for federal income tax purposes, of the income of a so-called family partnership. The case was properly decided by the Tax Court and the court below, and no question is presented here which would justify the granting of a writ of certiorari.

The petition for a writ of certiorari does not allege that the decision below is in conflict with any other decision, and we know of no conflict. The taxpayer merely argues that the decision be-

[2] The complete list of "withdrawals" or charges to her account for the period from January, 1942, through May, 1946, shows a great many charges for purely personal items, such as oil and gas, state and federal taxes, together with a regular monthly withdrawal of $400 per month for the last two years covered by the statement. (R. 64–69.)

low is wrong, but we submit there is no merit to the argument. (Pet. 8–16.) The case is controlled by the decisions of this Court in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, and is in accord with innumerable decisions of the Tax Court and the several Circuit Courts of Appeals.

As this Court pointed out in the *Tower* case, *supra* (p. 286), a partnership is generally said to be created when persons join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses. But no such arrangement was intended or accomplished here. There was no change in the taxpayer's business or its management after the purported gift of an interest therein to his sister and the creation of the so-called partnership. No new capital was added and nothing was contributed by the sister in the way of services. The taxpayer had been regularly contributing to the support of his mother, and apparently to the support of his sister. The taxpayer admitted that the arrangement had no valid business purpose. (R. 37.) He would not have made the same arrangement with an outsider. (R. 19.) The Tax Court found that one of his purposes in entering into the arrangement was to reduce his income taxes. Another was to provide his sister with additional income and estate in order to help support their mother. (R. 19.)

The internal revenue laws have never condemned family partnerships as such. They have never discriminated in favor of or against such partnerships. The most that can be said is that the courts generally have subjected such arrangements to more careful scrutiny because of the intimate family relationship. In every partnership case, so far as the federal income tax laws are concerned, the question, regardless of whether a family group is concerned or not, is whether a genuine business partnership has been created, and this question must be determined from the evidence in the particular case. Here the evidence fully supports the decision of the Tax Court that the taxpayer's sister was not a partner in his business for Federal income tax purposes, and the court below properly affirmed its decision.

CONCLUSION

The decision of the court below is correct. It is supported by the facts and the law, and is not in conflict with any other decision. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1948.

APPENDIX

Internal Revenue Code (as amended by Sec. 1, Public Salary Tax Act of 1939, c. 59, 53 Stat. 574):

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1940 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. 1940 ed., Sec. 182.)

SEC. 3797. DEFINITION.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent,

dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. * * * In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

SEC. 19.181–1. *Partnerships.*—Partnerships as such are not subject to taxation under the Internal Revenue Code, but are required to make returns of income. * * *

SEC. 19.182–1 [as amended by T. D. 5217, 1943 Cum. Bull. 314, 336]. *Distributive share of partners.*—(a) Each partner is required to include in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed:

(1) For any taxable year beginning after December 31, 1938, and before January 1, 1942, as part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership; and for any taxable year beginning after December 31, 1941, as part of his gains or losses from sales or exchanges of capital assets held for not more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than six months.

(2) For any taxable year beginning after December 31, 1938, and before January 1, 1942, as part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership; and for any taxable year beginning after December 31, 1941, as part of

his gains and losses from sales or exchanges of capital assets held for more than six months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than six months.

(3) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

* * * * *

SEC. 19.3797–4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. * * *

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